



DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

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4942.05-01

Contact Person:

Identification Number:

Telephone Number:

Employer Identification Nos:

Legend

A =

B =

C =

D =

E =

a =

b =

Date x =

Date y =

Date z =

Date aa =

Dear :

This is in response to a letter from your authorized representative requesting rulings on your behalf under sections 507 and 4942 of the Internal Revenue Code with respect to a proposed transfer of operating assets from A to B.

Facts

On Date x, A was formed as a nonprofit corporation under the laws of the State of D. In Date y, the Internal Revenue service recognized A as an organization described in section 501(c)(3) of the Code and classified it as a private operating foundation under section 4942(j)(3). A operates three museums and a non-commercial radio station covering local news; it makes grants for emergency and disaster relief; it operates a resource center for public school teachers and a performing arts theater; and is constructing a new science center/museum.

A was founded by Mr. and Mrs. E. The E family controls A's board of directors and thus controls A's operations. The majority of A's financial support is received from interest, dividends, and capital gains from A's endowment. A portion of the museum's revenues consists of membership dues and admission fees.

A's board of directors concluded that the programs of the three museums could be expanded through more efficient operations and the attraction of broader public support in a separate, publicly supported organization. Therefore, in Year z, A formed B, subsequently known as C.

On Date z, B was formed as a nonprofit corporation under the laws of the State of D. On Date aa, the Internal Revenue Service recognized B as an organization described in section 501(c)(3) of the Code and issued an advance ruling that B is classified as an organization described in section 509(a)(2). B was founded by Mr. and Mrs. E and the E family controls B's board of directors. In the first several years of B's existence, the majority of projected financial support will come from grants from A. B will also receive revenues from admissions charges to the museums, membership fees, and gifts and contributions from the general public.

As B grows in experience and recognition over time, it expects to receive more contributions from the general public and less from A. B plans to continue operating as a public charity under section 509(a)(2) of the Code.

Currently, B's board of directors is composed of the same individuals who serve on A's board. A majority of these individuals are members of the E family. The board of B intends to expand the composition of its board to include individuals who are not members of the E family. This will increase the number of independent individuals who serve on B's board. However, even after this expansion, the majority of B's board will be composed of members of the E family.

A proposes to divide its assets and activities by transferring to B for no consideration A's three museums, consisting of museum buildings and museum exhibits ("Museum Assets"), representing approximately a% of A's total assets and having a value of approximately \$b. After the proposed transfer, A intends to continue carrying on its other charitable activities in the same manner as it does currently.

The activities of B will consist of operating the three museums and their educational programs, acquiring works of art and artifacts, and carrying out fundraising activities to obtain support to operate the museums.

Currently, by agreement between A and B, B has assumed from A the responsibilities for the operation of the three museums that are owned by A. A reimburses B on a cost basis for all operating expenses in excess of the museums' revenues.

B is, and will be, financially accountable to A and will provide A with regular reports as to the use and expenditure of funds. B will also provide to A annual program reports outlining the goals and objectives it has accomplished, a detailed financial accounting, outside funding sources and plans to expand such sources, and results of certified audits of financial statements for so long as A provides operating support to B. A and B represent that these reports will be

sufficient to meet the expenditure responsibility requirements of section 4945(h) of the Code in the event that A needs to rely upon those provisions.

E, the founder of A, will remain directly engaged in the work of B, lending his expertise, skill and experience to the curators and other staff members of B. Also, the other members of the board of directors of A, who have expertise in the operation of the museums, will continue to provide their direct involvement in and support for the work of the staff employed by B. A's construction staff will assist B in construction and renovation projects for the museum facilities as needed. Also, A's employees experienced in fundraising will be transferred to B on a full-time basis and their salaries covered by A to assist B in the development of a broad-based campaign for public support of B. As a result, A will continue to be significantly involved in B's operations.

Recently, B hired three development employees to carry out a development plan that seeks from the general public outright cash donations, planned gifts, upper level annual memberships, event and exhibition sponsorships and donations of collection items, including artwork, artifacts, library and archive materials, and other objects. In addition, B hired a professional fundraiser to help manage a capital campaign with a goal of raising many millions of dollars. B has represented that classification as a public charity will enhance its ability to attract contributions from the general public and from private foundations.

A has not given and will not give notice to the Internal Revenue Service of the termination of its private foundation status in connection with the proposed transfer of its Museum Assets to B. A intends to continue to operate as an private operating foundation.

Rulings Requested

1. The proposed division of A's assets by means of a transfer of Museum Assets from A to B will not cause a termination of A's private foundation status under section 507 of the Code and will not result in the imposition of a termination tax under section 507(c).
2. The proposed division of A's assets by means of a transfer of Museum Assets from A to B will not, by itself, have an adverse effect on the current status of A as a private operating foundation described in sections 501(c)(3) and 4942(j)(3) of the Code.
3. A's provision of financial support to B in close coordination with A's provision of support for and involvement of the staff in B's programs will constitute expenditures made directly for the active conduct of activities constituting A's exempt purpose within the meaning of section 4942(j)(3) of the Code.
4. The proposed division of A by means of a transfer of assets from A to B will not give rise to the receipt by A of any amount from the sale or disposition of its assets within the meaning of section 4942(g)(1)(B) of the Code.
5. If A should fail to qualify as an operating foundation for the year in which the proposed division of its assets with B occurs, the amount of the assets transferred to B will not be

included in the distributable amount of A within the meaning of section 4942(d) of the Code.

Law and Analysis

Ruling 1

Law

Section 507(a)(1) of the Code provides that, except as provided in section 507(b), the status of an exempt organization as a private foundation will be terminated if it notifies the Secretary of its intent to terminate.

Section 507(a)(2) of the Code provides that, except as provided in section 507(b), the status of an exempt organization as a private foundation will be terminated if it commits willful, repeated acts (or failures to act), or a willful and flagrant act (or failure to act), that gives rise to the imposition of excise taxes under Chapter 42, and either the organization pays the tax imposed by section 507(c) or has the tax abated.

Section 507(b)(1)(A) of the Code provides that the status of a private foundation with respect to which there have not been either willful repeated acts (or failures to act) or a willful flagrant act (or failure to act) giving rise to liability for tax under Chapter 42 is terminated if the foundation distributes all of its net assets to one or more organizations described in section 170(b)(1)(A), each of which has been in existence and so described for a continuous period of at least 60 calendar months preceding the distribution.

Section 507(b)(1)(B) of the Code provides, generally, that the status as a private foundation of any organization is terminated if:

- (i) The organization meets the requirements of paragraph (1), (2) or (3) of section 509(a) for a continuous period of 60 calendar months;
- (ii) The organization notifies the IRS before the commencement of the 60-month period that it is terminating its private foundation status; and,
- (iii) The organization establishes to the satisfaction of the IRS immediately after the expiration of the 60-month period that it has complied with section 507(b)(1)(B)(i) of the Code.

Analysis

A has not notified, and does not intend to notify, the Internal Revenue Service of its intent to terminate voluntarily its private foundation status under section 507(a)(1) of the Code.

In addition, A has not committed willful, repeated acts (or failures to act), or a willful and flagrant act (or failure to act), that would give rise to the imposition of excise taxes under Chapter 42 of

the Code. Therefore, A's status as a private foundation will not be involuntarily terminated under section 507(a)(2).

Further, because A will not be distributing all of its net assets in the proposed transfer, A's status as a private foundation will not be terminated under section 507(b)(1)(A) of the Code.

Finally, since A will not meet any of the requirements of section 507(b)(1)(B), A's status as a private foundation will not be terminated under this provision.

Therefore, following the proposed transfer of some of A's Museum Assets to B, A will continue to be treated as a private foundation. Since A's status as a private foundation will not be terminated, A will not be required to pay the foundation termination tax imposed by section 507(c) of the Code.

Rulings 2 – 4

Law

An organization is described in section 501(c)(3) of the Code if it is organized and operated exclusively for exempt purposes.

Section 4942(a)(1) of the Code imposes an excise tax on certain undistributed income of a private foundation. However, this tax does not apply to a private foundation that is an operating foundation as defined in section 4942(j)(3).

Section 4942(g) of the Code defines the term "qualifying distributions" as meaning either any amount paid to accomplish one or more purpose described in section 170(c)(2)(B) (which includes religious, charitable, scientific, literary, and educational purposes) or any amount paid to acquire an asset used directly in carrying out one or more such exempt purposes.

Section 4942(j)(3) of the Code and section 53.4942(b)-1(a)(1) of the Foundation and Similar Excise Taxes Regulations provide that the term "operating foundation" means a private foundation that satisfies an "income" test and that satisfies either the "assets" test in section 53.4942(b)-2(a), the "endowment" test in section 53.4942(b)-2(b), or the "support" test in section 53.4942(b)-2(c). Included in this definition is the requirement that the foundation make qualifying distributions (within the meaning of section 4942(g)(2) of the Code) directly for the active conduct for the activities constituting the purpose or function for which it is organized and operated.

The "income" test, described in Section 53.4942(b)-1(a)(1) of the regulations, requires that the private foundation makes "qualifying distributions" directly for the active conduct of activities constituting its tax-exempt purpose that are equal to substantially all of the foundation's adjusted net income or minimum investment return.

Section 53.4942(b)-1(b) of the regulations provides that qualifying distributions are not made by a foundation directly for the active conduct of activities constituting its charitable, educational, or other similar exempt purpose unless such qualifying distributions are used by the foundation itself, rather than by or through one or more grantee organizations which receive such qualifying distributions directly or indirectly from such foundation. Amounts paid to acquire or maintain assets which are used directly in the conduct of the foundation's tax-exempt activities are considered direct expenditures for the active conduct of the foundations' tax-exempt activities. Likewise, administrative expenses and other operating costs necessary to conduct the foundation's exempt activities are treated as qualifying distributions expended directly for the active conduct of such exempt activities if they are reasonable.

Section 53.4942(b)-2(b)(1) of the regulations provides that a foundation will satisfy the "endowment test" if it normally makes qualifying distributions directly for the active conduct of its tax-exempt activities, in an amount equal to at least two-thirds of its minimum investment return.

Analysis

A private foundation is an "operating foundation" under section 4942(j) of the Code if it meets the requirements of that provision and section 53.4942(b)-1(a)(1) of the regulations. These requirements, described in section 53.4942(b)-1, consist of an "income test" and three alternative tests (the "assets," "endowment," and "support" tests).

Currently, A is classified as a private operating foundation under section 4942(j) of the Code. After the proposed transfer, A will continue carrying on its other charitable activities in the same manner as it had before the transfer, except for the operation of Museum Assets it will transfer to B. In addition, A will continue to provide substantial economic support to B in operating the museums. Therefore, A's transfer of its Museum Assets to B, by itself, will not adversely affect A's ability to continue to comply with the "income" test and the "endowment" test in section 53.4942(b)-2(b)(1) of the regulations. Therefore, the proposed transfer, by itself, will not adversely affect A's current classification as a private operating foundation under section 4942(j)(3) of the Code.

Currently, A reimburses B on a cost basis for all operating expenses in excess of revenues of the museums. Following the proposed transfer, in the first several years of B's existence, it is expected that the majority of B's financial support will come from grants from A. Further, E will remain directly engaged in the work of B, and the other members of A's board of directors, who have expertise in the operation of the museums, will continue to be directly involved in and to support for the work of the staff employed by B. A's construction staff will assist B in construction and renovation projects for the museum facilities as needed. In addition, A's employees who are experienced in fundraising will be transferred to B on a full-time basis and their salaries will be covered by A to assist B in the development of a broad-based campaign for public support of B. Therefore, A will continue to be significantly involved in B's operations. As a result, under section 4942(j)(3) of the Code, A's provision of financial and staff support to and for the benefit of B in operating the museums will constitute qualifying expenditures made directly for the active conduct of activities constituting the purpose or function for which A is organized.

Section 4942(g) of the Code defines the term "qualifying distributions" as meaning either any amount paid to accomplish one or more purpose described in section 170(c)(2)(B) (which includes religious, charitable, scientific, literary, and educational purposes) or any amount paid to acquire an asset used directly in carrying out one or more such exempt purposes.

Under the proposed transfer, A will divide its assets and activities by transferring A's Museum Assets to B for no consideration. Thus, because A will be making a gratuitous transfer of property to B, A will be receiving no consideration from B in return. Therefore, A is not making any payment to B for the acquisition of any assets. As a result, A's proposed transfer of Museum Assets to B will not constitute an amount paid to acquire an asset used in carrying out an exempt purpose described in section 170(c)(2)(B) of the Code.

Ruling 5

Law

Section 8.03 of Rev. Proc. 2007-4, 2007-1 I.R.B. 118, 130, states that the Internal Revenue Service does not rule on hypothetical questions in a private letter ruling.

Analysis

Since we have ruled in Ruling 2 that A will continue to qualify as an operating foundation under section 4942(j)(3) of the Code, this ruling request is hypothetical. Therefore, we are not ruling on this hypothetical issue. See Section 8.03 of Rev. Proc. 2006-4, supra.

Rulings

1. The proposed division of A's assets by means of a transfer of Museum Assets from A to B will not cause a termination of A's private foundation status under section 507 of the Code and will not result in the imposition of a termination tax under section 507(c).
2. The proposed division of A's assets by means of a transfer of Museum Assets from A to B will not, by itself, have an adverse effect on the current status of A as a private operating foundation described in sections 501(c)(3) and 4942(j)(3) of the Code.
3. A's provision of financial support to B in close coordination with A's provision of support for and involvement of the staff in B's programs will constitute expenditures made directly for the active conduct of activities constituting A's exempt purpose within the meaning of section 4942(j)(3) of the Code.
4. The proposed division of A by means of a transfer of assets from A to B will not give rise to the receipt by A of any amount from the sale or disposition of its assets within the meaning of section 4942(g)(1)(B) of the Code.

5. Since we have ruled in Ruling No. 2 that A will continue to qualify as an operating foundation under section 4942(j)(3) of the Code, the ruling requested is hypothetical. We do not rule on hypothetical issues.

This ruling does not address the applicability of any section of the Code or regulations to the facts submitted other than with respect to the sections described.

Please keep a copy of this ruling in your permanent records.

This ruling is based on the understanding that there will be no material changes in the facts upon which it is based.

This ruling is directed only to the organization that requested it. Section 6110(k)(3) of the Code provides that it may not be used or cited by others as precedent.

This ruling will be made available for public inspection under section 6110 of the Code after certain deletions of identifying information are made. For details, see enclosed Notice 437, *Notice of Intention to Disclose*. A copy of this ruling with deletions that we intend to make available for public inspection is attached to Notice 437. If you disagree with our proposed deletions, you should follow the instructions in Notice 437.

If you have any questions about this ruling; please contact the person whose name and telephone number are shown in the heading of this letter.

In accordance with the Power of Attorney currently on file with the Internal Revenue Service, we are sending a copy of this letter to your authorized representative.

Sincerely yours,

Steven B. Grodnitzky
Manager
Exempt Organizations
Technical Group 1

Enclosure:
Notice 437